

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on the Nelson Mandela Bay Metropolitan Municipality and its municipal entity

Report on the audit of the consolidated and separate financial statements

Qualified opinion

1. I have audited the consolidated and separate financial statements of the Nelson Mandela Bay Metropolitan Municipality and its municipal entity (group) set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2019, the consolidated and separate statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget and actual amounts for the year then ended, as well as the notes to the consolidated and separate financial statements, including a summary of significant accounting policies.
2. In my opinion, except for the possible effects of the matters described in the basis for qualified opinion section of this auditor's report, the consolidated and separate financial statements present fairly, in all material respects, the consolidated and separate financial position of the group as at 30 June 2019, and financial performance and cash flows for the year then ended in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act no. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2018 (Act no.1 of 2018) (Dora).

Basis for qualified opinion

Trade and other payables

3. The municipality did not recognise all outstanding accruals meeting the definition of a liability in accordance with GRAP 1, *Presentation of financial statements*. This was as a result of an ineffective system of internal control to identify, record and report on all outstanding accruals and creditors at year-end. Consequently, I was unable to determine the full extent of the misstatement on trade and other payables stated at R2,2 billion, as disclosed in note 7 to the consolidated and separate financial statements; expenditure stated at R10,2 billion, as disclosed in the consolidated and separate statement of financial performance as well as value-added tax payable stated at R59,3 million, as disclosed in note 8 to the consolidated and separate financial statements as it was impracticable to do so.

Irregular expenditure

4. The municipality did not have proper systems in place to identify and record all irregular expenditure incurred in prior years. The corresponding balance for irregular expenditure in note 44.2 to the consolidated and separate financial statements was therefore misstated by an undeterminable amount. As a result, the closing balance of irregular expenditure in the current year stated at R16,5 billion as disclosed in note 44.2 to the consolidated and separate financial statements was also understated. I was unable to determine the full extent of the understatement as it was impracticable to do so with the available accounting records within the municipality.

Property, plant and equipment

5. The municipality did not appropriately account for and disclose property, plant and equipment in accordance GRAP 17, *Property, plant and equipment*. Certain community assets were incorrectly recorded in the fixed asset register and certain land belonging to the municipality was not disclosed in the fixed asset register. In addition, certain infrastructure assets could not be physically verified. The municipality did not also adequately assess whether there were any indications that the expectations on the useful lives of Property, plant and equipment had changed. As a result, I was unable to confirm the calculation of depreciation. I could not confirm the depreciation by alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to Property, plant and equipment stated at R17,4 billion (2017-18: R16,5 billion), and depreciation stated at R882,4 million and R881,7 million (2017-18: R636,8 million and R636,1 million) in note 9 and 31.1 to the consolidated and separate financial statements respectively. There was also an impact on the surplus for the period and on the accumulated surplus.
6. Furthermore, the municipality did not adequately disclose work-in-progress in accordance GRAP 17, *Property, plant and equipment*. The disclosure is limited to expenditure and does not include the total cumulative expenditure and closing balance for work-in-progress.

Intangible assets

7. The municipality capitalised an application system that was still under development contrary to GRAP 31, *Intangible assets*. As a result, intangible assets were overstated by R51,1 million. Additionally, the municipality did not adequately assess whether there were any indications that its expectations on the useful lives of intangible assets had changed, as required by this standard. As a result, I was unable to confirm the calculation of the related amortisation. I was also unable to physically verify certain intangible assets due to the status of the accounting records. I was unable to confirm these assets through alternative means. Consequently, I was unable to determine whether any further adjustments were necessary to the intangible assets stated at R368,7 million and R368,6 million (2017-18: R442,7 million and R442,6 million) and the amortisation stated at R90,8 million (2017- 18: R356,7 million) in note 11 and 31.3 to the consolidated and separate financial statements respectively.

Investment property

8. I was unable to obtain sufficient appropriate evidence for Investment property as the municipality did not maintain adequate records to determine ownership of these properties. I was unable to confirm investment property through alternative means. Consequently, I was unable to determine whether any adjustments were necessary to investment property stated at R216,8 million in note 12 to the consolidated and separate financial statements.

Exchange revenue – service charges

9. I was unable to obtain sufficient appropriate audit evidence that revenue from service charges had been properly accounted for as the municipality did not have adequate internal controls to maintain records for service charges. I was unable to confirm the revenue from service charges by alternative means. Additionally, the municipality did not bill and record certain revenue owing to it for services rendered, as required by GRAP 9, *Revenue from exchange transactions*. Consequently, I was unable to determine whether any adjustment was necessary to revenue from service charges stated at R5,2 billion (2017- 18: R5,2 billion) in note 21.1 to the consolidated and separate financial statements.

Unauthorised expenditure

10. I was unable to obtain sufficient appropriate audit evidence that the municipality correctly calculated unauthorised expenditure in the current year. This was as a result of the uncorrected misstatements identified which impacted on expenditure. I was unable to confirm the unauthorised expenditure by alternative means. Consequently, I was unable to determine whether any adjustments were necessary to the unauthorised expenditure stated at R250,3 million in note 44.1 to the consolidated and separate financial statements.

Context for the opinion

11. I conducted my audit in accordance with the International Standards on Auditing (ISAs). My responsibilities under those standards are further described in the auditor-general's responsibilities for the audit of the consolidated and separate financial statements section of this auditor's report.
12. I am independent of the municipality in accordance with sections 290 and 291 of the International Ethics Standards Board for Accountants' *Code of ethics for professional accountants*, and parts 1 and 3 of the International Ethics Standards Board for Accountants' *International Code of Ethics for Professional Accountants (including International Independence Standards)* (IESBA codes), as well as the ethical requirements that are relevant to my audit in South Africa. I have fulfilled my other ethical responsibilities in accordance with these requirements and the IESBA codes.
13. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Emphasis of matters

14. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Events after reporting date

15. As disclosed in note 46.1 to the consolidated and separate financial statements the municipality received correspondence from National Treasury on allegations relating to the Integrated Public Transport System grant indicating that if the municipality does not respond satisfactorily, National Treasury would recall the full allocation of approximately R3,1 billion which was transferred to the municipality. The correspondence between the municipality and National Treasury relating to this matter was in progress at the date of this report.

Restatement of corresponding figures

16. As disclosed in note 40 to the consolidated and separate financial statements, the corresponding figures for 30 June 2018 have been restated as a result of errors identified in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2019.

Material losses and impairment

17. As disclosed in note 15 and 16 to the consolidated and separate financial statements, material impairment allowances of R2,2 billion (2017-18: R1,8 million) and R859,2 million (2017-18: R750,7 million) were made against trade receivables – exchange and non-exchange transactions, respectively. The net movement in these impairment allowances together with the bad debts write-offs resulted in an impairment expense of R759,1 million (2017-18: R872,7 million).
18. As disclosed in note 35.9 to the consolidated and separate financial statements, material water losses of R169,6 million (2017-18: R162,9 million) were incurred, which represents 43,9% (2017-18: 43,9%) of total water cost. The non-technical losses of 34% were as a result of unauthorised consumption from theft or illegal use.
19. As disclosed in note 35.10 to the consolidated and separate financial statements, material electricity losses of R484,2 million (2017-18: R339,5 million) were incurred, which represents 15.47% (2017- 18:13.95%) of total electricity purchased. The non-technical losses of 9.47% were as a result of faulty meters, theft from illegal connections and meter tampering.

Underspending on conditional grants

20. As disclosed in note 22.21 to the consolidated and separate financial statements, the drought relief grant has an unspent portion amounting to R207,7 million. The grant is used for responding to the communities' needs with the aim to alleviate the immediate consequences of drought within the municipal area.

Other matter

21. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure note

22. In terms of section 125(2)(e) of the MFMA, the municipality and its municipal entity are required to disclose particulars of non-compliance with the MFMA in the consolidated and separate financial statements. This disclosure requirement did not form part of the audit of the consolidated and separate financial statements and, accordingly, I do not express an opinion on it.

Responsibilities of the accounting officer for the consolidated and separate financial statements

23. The accounting officer is responsible for the preparation and fair presentation of the consolidated and separate financial statements in accordance with the SA Standards of GRAP and the requirements of the MFMA and Dora, and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.
24. In preparing the consolidated and separate financial statements, the accounting officer is responsible for assessing the group's ability to continue as a going concern, disclosing, as applicable, matters relating to going concern and using the going concern basis of accounting unless the appropriate governance structure either intends to liquidate the municipality or to cease operations, or has no realistic alternative but to do so.

Auditor-general's responsibilities for the audit of the consolidated and separate financial statements

25. My objectives are to obtain reasonable assurance about whether the consolidated and separate financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with the ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated and separate financial statements.
26. A further description of my responsibilities for the audit of the consolidated and separate financial statements is included in the annexure to this auditor's report.

Report on the audit of the annual performance report

Introduction and scope

27. In accordance with the Public Audit Act of South Africa, 2004 (Act no. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report material findings on the reported performance information against predetermined objectives for the selected key performance areas presented in the annual performance report. I performed procedures to identify findings but not to gather evidence to express assurance.

28. My procedures address the reported performance information, which must be based on the approved performance planning documents of the municipality. I have not evaluated the completeness and appropriateness of the performance indicators /measures included in the planning documents. My procedures also did not extend to any disclosures or assertions relating to planned performance strategies and information in respect of future periods that may be included as part of the reported performance information. Accordingly, my findings do not extend to these matters.
29. I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected key performance area presented in the annual performance report of the municipality for the year ended 30 June 2019:

Key performance area	Pages in the annual performance report
KPA 1 – Basic service delivery	x – x

30. I performed procedures to determine whether the reported performance information was properly presented and whether performance was consistent with the approved performance planning documents. I performed further procedures to determine whether the indicators and related targets were measurable and relevant, and assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
31. The material findings in respect of the usefulness and reliability of the selected key performance area are as follows:

KPA 1 – Basic service delivery

Various indicators

32. The systems and processes that enable reliable reporting of the achievement against various targets was not adequately designed. As a result, I was unable to obtain sufficient appropriate audit evidence for the reported achievements. Limitations were placed on the scope of my work as I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the indicators listed below as reported in the annual performance report:

Indicator	Reported achievement
KPI 1 –Percentage service delivery complaints and faults resolved within the timeframes stipulated in the service delivery standards	25%
KPI 7 -Percentage of complaints/callouts responded to within 24 hours (sanitation/wastewater)	98.37%
KPI 8 -Percentage of complaints/callouts responded to within 24 hours (water)	99.12%

KPI 5 – Percentage completion of the Coega Kop boreholes exploration

33. The indicator is inconsistently presented and disclosed in the annual performance report as phase 1 as all the evidence and reported information relates to phase 3.

Various indicators

34. I was unable to obtain sufficient appropriate audit evidence for the reported achievements for various indicators. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievements by alternative means. Consequently, I was unable to determine whether any adjustments were required to the achievement of the indicators listed below as reported in the annual performance report:

Indicator	Reported achievement
KPI 20 - Percentage of unplanned outages that are restored to supply within industry standard timeframes	99.1%
KPI 25 - Percentage of known informal settlements receiving integrated waste handling services	99.2%
KPI 26 - Percentage of known formal settlements receiving integrated waste handling services	100%
KPI 55 - Average number of days taken to process building plan applications	7.16 days

Other matters

35. I draw attention to the matters below.

Achievement of planned targets

36. Refer to the annual performance report on pages ... to ... for information on the achievement of planned targets for the year. This information should be considered in the context of the material findings on reliability of the reported performance information in paragraph 32 to 34 of this report.

Adjustment of material misstatements

37. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of KPA 1: Basic service delivery. As management subsequently corrected only some of the misstatements, I raised material findings on the usefulness and reliability of the reported performance information. Those that were not corrected are reported above.

Report on the audit of compliance with legislation

Introduction and scope

38. In accordance with the PAA and the general notice issued in terms thereof, I have a responsibility to report material findings on the compliance of the municipality with specific matters in key legislation. I performed procedures to identify findings but not to gather evidence to express assurance.

39. The material findings on compliance with specific matters in key legislations are as follows:

Annual financial statements

40. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122(1) of the MFMA. Material misstatements of trade and other payables, employee benefits, the statement of cash flows and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Strategic planning and performance management

41. The performance management system and related controls were inadequate as it did not describe how the performance monitoring, measurement, review and reporting improvement processes should be conducted, as required by municipal planning and performance management regulation 7(1).

Asset management

42. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Revenue management

43. An effective system of internal control for revenue was not in place, as required by section (64(2)(f) of the MFMA.

44. Interest was not charged on all accounts in arrears, as required by section 64(2)(g) of the MFMA.

45. Revenue due to the municipality was not calculated on a monthly basis, as required by section 64(2)(b) of the MFMA.

Conditional grants

46. Performance in respect of programmes funded by the Public Transport Network Grant was not evaluated within two months after the end of the financial year, as required by section 12(5) of the Dora.

Expenditure management

47. Reasonable steps were not taken to ensure that the municipality implements and maintains an effective system of expenditure control, including procedures for the payment of funds, as required by section 65(2)(a) of the MFMA.

48. Money owed by the municipality was not always paid within 30 days as required by section 65(2)(e) of the MFMA.

49. Reasonable steps were not taken to prevent irregular expenditure amounting to R2,1 billion, as disclosed in note 44.2 to the consolidated and separate financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed irregular expenditure was caused by non-compliance with supply chain management (SCM) regulations.
50. Reasonable steps were not taken to prevent fruitless and wasteful expenditure amounting to R15,6 million, as disclosed in note 44.3 to the consolidated and separate financial statements, in contravention of section 62(1)(d) of the MFMA. The majority of the disclosed fruitless and wasteful expenditure was as a result of salaries paid to employees suspended for more than 90 days.
51. Reasonable steps were not taken to prevent unauthorised expenditure, as required by section 62(1)(d) of the MFMA. The full extent of the unauthorised expenditure could not be quantified as indicated in the basis for qualification paragraph. The majority of the disclosed unauthorised expenditure was caused by the overspending of the total amount appropriated for a vote in the approved budget.

Consequence management

52. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.
53. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.
54. Cases of financial misconduct which constitute a crime committed by officials were not always reported to the South African Police Service, as required by the municipal regulations on financial misconduct procedures and criminal proceedings 10(1).
55. Allegations of theft / fraud which exceeded R100 000 were not reported to the South African Police Service, as required by section 34(1) of the Prevention and Combating of Corrupt Activities Act, 2004 (Act no. 12 of 2004).

Procurement and contract management

56. Sufficient appropriate audit evidence could not be obtained that all quotations were awarded in accordance with the legislative requirements as the municipality fully implemented systems for the acceptance of quotations, however these systems were not appropriately designed to ensure that they fully complied with the SCM legislation.
57. Some of the goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1). Similar non-compliance was also reported in the prior year.
58. Sufficient appropriate audit evidence could not be obtained that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5. Similar non-compliance was also reported in the prior year.

59. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA. Similar non-compliance was also reported in the prior year.

Other information

60. The accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the consolidated and separate financial statements, the auditor's report and the selected key performance area presented in the annual performance report that have been specifically reported in this auditor's report.
61. My opinion on the consolidated and separate financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.
62. In connection with my audit, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the consolidated and separate financial statements and the selected key performance area presented in the annual performance report, or my knowledge obtained in the audit, or otherwise appears to be materially misstated.
63. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

Internal control deficiencies

64. I considered internal control relevant to my audit of the consolidated and separate financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.
65. There was instability at the leadership level, and leadership did not take decisive steps to implement adequate consequence management, action plans, and key controls, or monitor policies and procedures in a manner that promoted a sound control environment.
66. Management did not consistently implement daily, weekly and monthly financial and performance management disciplines. This was due to a lack of oversight by leadership and vacancies in key positions, combined with systemic weaknesses in information technology systems that were reported on repeatedly and not addressed. Key risks relating to financial and performance reporting as well as supply chain management were not actively managed during the year under review.
67. Management's processes of monitoring compliance with legislation were not effective as a result of the significant internal control deficiencies detailed in the aforementioned paragraphs.

Material Irregularities

68. In accordance with the PAA and the material irregularities regulations, I have a responsibility to report on material irregularities identified during the audit.
69. I identified material irregularities during the audit and notified the accounting officer thereof as required by material irregularity regulation 3(2). By the date of this auditor's report, I had not yet completed the process of evaluating the responses from the accounting officer. These material irregularities will be included in next year's auditor's report.

Other reports

70. I draw attention to the following engagements conducted by various parties that had, or could have, an impact on the matters reported in the consolidated and separate financial statements, reported performance information, compliance with applicable legislation and other related matters. These reports did not form part of my opinion on the consolidated and separate financial statements or my findings on the reported performance information or compliance with legislation.
71. There were 16 investigations reported during the year under review by the forensic division of the internal audit unit at the municipality. Seven investigations were finalised at year end. Completed investigations related to claims which were found to be unsubstantiated or cases requiring further investigation by the referring directorate or another investigative authority. Outstanding cases related to allegations of irregular appointments, payments to service providers for services not rendered and alleged irregular expenditure incurred.
72. An investigation is being conducted by the Hawks relating to the procurement of a drainage system by the municipality. The investigation is in progress.

East London

2 March 2020



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Annexure – Auditor-general's responsibility for the audit

1. As part of an audit in accordance with the ISAs, I exercise professional judgement and maintain professional scepticism throughout my audit of the financial statements, and the procedures performed on reported performance information for the selected key performance area and on the municipality's compliance with respect to the selected subject matters.

Consolidated and separate financial statements

2. In addition to my responsibility for the audit of the consolidated and separate financial statements as described in this auditor's report, I also:
 - identify and assess the risks of material misstatement of the consolidated and separate financial statements whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control
 - obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control
 - evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the accounting officer
 - conclude on the appropriateness of the accounting officer's use of the going concern basis of accounting in the preparation of the consolidated and separate financial statements. I also conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the group's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the consolidated and separate financial statements about the material uncertainty or, if such disclosures are inadequate, to modify the opinion on the consolidated and separate financial statements. My conclusions are based on the information available to me at the date of this auditor's report. However, future events or conditions may cause a group to cease continuing as a going concern
 - evaluate the overall presentation, structure and content of the consolidated and separate financial statements, including the disclosures, and whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Communication with those charged with governance

3. I communicate with the accounting officer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit.
4. I also confirm to the accounting officer that I have complied with relevant ethical requirements regarding independence, and communicate all relationships and other matters that may reasonably be thought to have a bearing on my independence and, where applicable, related safeguards.